

Been There, Done That. Got the T-Shirt, Mug, and Hat.

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In his Better Buying Power memorandum, the under secretary of Defense (acquisition, technology and logistics) told us: "We must therefore strive to achieve what economists call productivity growth: in simple terms, to DO MORE WITHOUT MORE." He outlined several ways to accomplish that goal, which is not an easy one.

We offer examples of successful implementation from defense acquisitions we have worked. Some might be appropriate for an effort you are pursuing, and others not. Ultimately, you need to be flexible in pursuing the art of the possible. As you do so, we offer a suggestion: get industry partners involved early. They can provide many innovative suggestions. And ultimately, they will be responsible for making your program a success.

So let's start at the beginning of the memorandum and work toward the back. We won't be stopping everywhere; there's not enough space in a single article to do so.

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TARGET AFFORDABILITY AND CONTROL COST GROWTH

Mandate affordability as a requirement.

Specifically, at Milestone A, my Acquisition Decision Memorandum (ADM) approving formal commencement of the program will contain an affordability target to be treated by the program manager (PM) like a Key Performance Parameter (KPP) such as speed, power, or data rate—i.e., a design parameter not to be sacrificed or compromised without my specific authority. At Milestone B, when a system's detailed design is begun, I will require presentation of a systems engineering tradeoff analysis showing how cost varies as the major design parameters and time to complete are varied.

Design-to-cost

One way to achieve this principal action is design-to-cost. Design-to-cost is a concept that establishes cost elements as management goals to achieve the best balance between life-cycle cost, acceptable performance, and schedule. Under design-to-cost, cost is a design constraint during the design and development phases and a management discipline throughout the acquisition and operation of the system or equipment. One of the authors participated in the development of the acquisition strategy for a successful program that included design-to-cost. As part of the request for proposals (RFP), the government laid out in descending order of importance the 23 major requirements that the program hoped to achieve, including specifying nine minimum mandatory requirements that had to be achieved for consideration for award. Based on the budget specified in the solicitation, the offerors were to “draw a line” based on what they believed they could achieve.

INCENTIVIZE PRODUCTIVITY AND INNOVATION IN INDUSTRY

Adjust progress payments to incentivize performance.

As a matter of practice, on all fixed price type contracts, I expect that the basis of negotiations shall be the use of customary progress payments. After agreement on price on the basis of customary progress payments, the contractor shall have flexibility to propose an alternate payment arrangement for the Government's consideration.

In the memorandum, the under secretary writes, “By having determined the projected contract cost, the contracting officer should be able to determine the consideration being offered by the contractor for a more favorable payment structure. The benefits of that improved cash flow shall be documented....”

So, let's talk about cash flow, from the general to the specific.

What is cash flow?

Based on the Random House Dictionary, Dictionary.com defines cash flow as:

- noun

the sum of the after-tax profit of a business plus depreciation and other noncash charges: used as an indication of internal funds available for stock dividends, purchase of buildings and equipment, etc.

In other words, think of it as the measurement of a company's cash in (paid) and out (spent).

Cash flow: It's what accountants worry about, not something Defense Department program managers and contracting officers need to be concerned about. Right? *Not so fast.* With the call for efficiencies in defense spending comes an emphasis on this “thing” called cash flow; it's not just for accountants any more. The current plan calls for each Service to select a pilot program and for the director of defense procurement and acquisition policy (DPAP) to develop a “cash flow model” to be used by contracting officers when using other than customary progress payments. But don't simply cross your fingers, hope your program is not selected as a pilot program, and then breathe a sigh of relief. No, now is the time to begin to understand cash flow, and increase your situational awareness before a question comes—and believe us, a question will come.

The following discussion is aimed at helping program managers and contracting officers begin to tackle this issue by answering a few questions. What is cash flow? What affects it? And how does a program manager or contracting officer figure out the cash flow status of his/her program and use it to save money?

How do payment arrangements affect cash flow?

The USD (AT&L) memorandum discusses the use of “alternate payment arrangements.” What does that mean? Here are some things to consider in understanding payment arrangements and their relationship to cash flow:

- Payments. Money at rest is money available to make more money.
 - Government to Prime contractor. How long after the prime incurs a cost does the government provide the funds to cover the cost? And how much of that incurred cost? The longer the time between incurring the cost and getting funds, the longer the contractor may have to borrow the money to cover his cost. This adds to the government's costs. Shorter timelines, and greater amounts, are preferred.
 - Prime contractor to subcontractors. What is the arrangement? The relationship between the prime and its subcontractors may generate cash. Specifically, the longer the time between when the prime gets funding for work the subcontractors have performed and when

the subcontractors are subsequently paid, the longer the contractor(s) could earn interest or invest the funds.

- Lease/Rent/Buy. This is another area that could generate a positive cash flow. For instance, rather than buy a facility a contractor could choose to lease a facility used for their production effort. From a cash flow perspective, the company has very little money invested and, depending on the contractual arrangements it has with both the government and the lease holder, may simply be able to pass the monthly cost to the government; never having to “spend” its own cash.

How does a program manager or contracting officer figure out the cash flow status of his/her program and use it to save money?

A good place to start is with DCMA and DCAA representatives. They have the right technical expertise, access to company financials, and unique insights that will help you to understand an individual contractor’s particular cash flow situation.

Inside the program, the program manager and contracting officer can begin to gain an understanding of the contractor’s cash flow by examining the payment schedules discussed previously.

- For example, it may be that transitioning from progress payments to performance-based payments between the government and the prime contractor, or the prime and its subcontractors, could reduce the amount of time either the prime or a subcontractor has to “carry” costs (i.e., borrow money) and potentially reduce the overall costs to the program.
- It may also be insightful for a program manager and contracting officer to examine the status of leased vs. owned facilities and equipment. There may be areas where it may be more beneficial to change the current arrangements within the program to decrease expenses.

The concept of cash flow is not new—but, it is likely a new focus area for most DoD program managers and contracting officers. As more is learned from the Services’ pilot programs, additional information will come out to help program managers and contracting officers optimize their programs’ cash flow. Until then, program managers and contracting officers need to understand the concept, know what affects it, and develop a plan to improve cash flow opportunities to reduce program costs.

Now, a specific example:

Interim Acceptance for Billing Purposes

The production contract for the first two Defense Satellite Communications System (DSCS) III spacecraft began life as a letter contract. As part of the definitization of the letter contract, the Air Force and the General Electric Space Division negotiated an agreement on price on the basis of customary progress payments. However, the contractor proposed that the final agreement contain a mechanism to liquidate prog-

ress payments and book sales each year, rather than waiting until the end of a lengthy production period, which would extend over several years. The Air Force and GE reached an agreement to create a special contract requirement and contract line/sub-contract line item structure that would allow the contractor to offer, and the government to accept some CLINS/SLINS on an interim basis for billing purposes, with final acceptance reserved for the completed spacecraft at Cape Canaveral. The Air Force estimate of the reduced contract cost for establishing these “billing points” was \$4.5 million. The modification that added the second two DSCS III production satellites contained a similar structure, with similar savings.

PROMOTE REAL COMPETITION

Remove obstacles to competition.

Exchanges with Industry Before Receipt of Proposals

While talking to program managers at the Defense Systems Management College and doing mission assistance, we often hear feedback about the reluctance to conduct one-on-one meetings with potential offerors, usually for fear of protests. Such meetings are specifically allowed by Federal Acquisition Regulation (FAR) 15.201(c)(4), as part of the discussion of exchanges with industry before receipt of proposals. The truth is that protests, although painful, are not particularly frequent, and the government is successful in most protests. During 2010 the entire federal government executed millions of acquisitions, but GAO reports only 2,299 protests, with only 441 having “merit” and only 82 “sustained” (GAO report B-158766, 23 Nov 2010).

There are good reasons to use one-on-one meetings to promote competition. Let’s look at one example.

On January 28, 1986, the space shuttle *Challenger* disaster occurred, and instantly, the Department of Defense was largely left with no way to launch critical national security payloads. The Department instituted a National Space Launch Recovery Program to regain that capability, part of which was the Medium Launch Vehicle (MLV) Program, to meet the requirement to launch Global Positioning System (GPS) satellites. The disaster eventually resulted in a 32-month standdown in the shuttle program.

As part of the market research to determine what expendable launch vehicles could meet the MLV requirement, a team including the program manager, chief engineer, contracting officer and others, conducted meetings at facilities of potential offerors across the country. These one-on-on meetings were to determine contractor capabilities and to convince potential offerors of the government’s interest in full and open competition.

We went out of our way to include a major contractor that was not currently doing business with the Air Force, but, instead, with the NASA and Strategic Defense Initiative Organization

(SDIO), predecessor of today's Missile Defense Agency. We were told they weren't likely to propose, as they presumed the Air Force was seeking an "Air Force Blue Contractor." Our response was that this would be a fair competition and that the successful offeror would be decided based on the evaluation factors for award in Section M of the solicitation, not whether they were "Air Force Blue."

The contractor, McDonnell Douglas Astronautics Company, did propose and did win. Based upon the program office's independent cost estimate (ICE), that one-on-one meeting may have ultimately saved the government close to \$700 million, while providing a production and launch rate that exceeded the requirements of the request for proposals. The latter is an added bonus, as it addresses another of the principal actions in the USD(AT&L) memorandum, *Make production rates economical and hold them stable*, which is located in the major area, TARGET AFFORDABILITY AND CONTROL COST GROWTH.

REDUCE NON-PRODUCTIVE PROCESSES AND BUREAUCRACY

Reduce non-value-added overhead imposed on industry.

Special Termination Cost Clause and Termination Liability

Although we don't like to think about it, one of the potential outcomes of any contract is that the government may choose to terminate for convenience, and incur the associated costs for doing so. Termination costs are those costs that a contractor would incur solely allocable to the termination, including termination settlement and subcontractor claims, or costs amortized over the contract life. Funding this at a contract level appears to be an inefficient cash flow approach as most contracts are never terminated. Under this present approach, contractors reserve sufficient funds within existing contract funding for a potential termination and these funds remain on the contract unused, albeit declining, until contract completion. These funds are finally used up at the end of the contract. One alternative to this way of doing business is to use a Special Termination Cost Clause (STCC).

The authors have used the Special Termination Cost Clause at DFARS 252.249-7000 in several incrementally funded contracts. The clause directs the contractor to exclude from its estimate of costs incurred or to be incurred. The DOD Financial Management Regulation requires the Service or agency to cover expected termination costs from unobligated balances. The STCC is intended to improve cash flow efficiency by reducing the costs that contractors reserve for termination liability, which can amount to millions, or tens of millions of dollars. The clause makes more funds available early in a program's life to do "real work" and accelerate performance. And remember, time is money. Ultimately, barring termination for the convenience of the government, the final end price or cost for the contract remains unchanged.

The Special Termination Cost Clause has the potential to improve contract or program efficiency and effectiveness. Now, just imagine if the Services and agencies used the authority to the maximum extent that they could. Or, better yet, think about how much additional buying power the Department might be able to achieve, if Congress were to allow the establishment of a "termination liability pool." A common pool, based on historical data of the actual number of terminations and costs incurred would be significantly less than having contractors account for termination liability on each and every contract. The use of a single termination pool may have the potential of freeing up billions of dollars and assisting the Department in achieving better buying power.

REDUCE NON-PRODUCTIVE PROCESSES AND BUREAUCRACY

Milestone Budgeting—Requirements and Funding Stability (DEP/MLV)

The authors are hesitant to directly associate this particular discussion with the principal action *Eliminate low-value-added statutory processes*. However, after reading the discussion, readers may draw their own conclusions. Most program managers and contracting officers may consider this to be above their pay grades, but there is great potential for better buying power.

Back in the 1987 Defense Authorization Act, Congress allowed DoD to initiate the use of milestone budgeting for a limited number of programs that were labeled Defense Enterprise Programs (DEPs). DEPs, such as the Air Force's Medium Launch Vehicle (MLV), were placed outside of the normal process by which Congress evaluates and authorizes funding for programs on an annual basis, while the Department's senior decision makers review programs in detail at key milestones. These "enterprise programs" were a recommendation of the Packard Commission, to put Congress on a milestone basis rather than annual reviews. The commission wanted to reduce funding uncertainties of the annual authorization and appropriation processes to enhance program stability. DEPs also had streamlined oversight, which provided a more efficient management structure. On the MLV program, this approach allowed the program office and the contractor to concentrate on program execution, and achieve a remarkable 20 for 20 launch success rate.

Bottom Line

The bottom line is best summed up in the last two sentences of the Better Buying Power memorandum: "I am tasking all of you to absorb this guidance memo and begin acting on it within the scope of your existing authority. There is no time to lose."

It's up to us and our collective ingenuity to make this work!

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